SPJIMR
Bharatiya Vidya Bhavan

International Accounting Standards Board

Columbus Building

7 Westferry Circus

Canary Wharf

London E14 4HD

United Kingdom

June 17th, 2019

Submitted electronically

Dear Sir/Madam

Subject: Exposure Draft ED/2019/1 Interest Rate Benchmark Reform

I am writing on behalf of the Centre for Financial Studies at SPJIMR Business School, Mumbai. We are pleased to provide our comments on ED/2019/1 – Interest Rate Benchmark Reform: Proposed Amendments to IFRS 9 and IAS 39.

We appreciate the IASB's efforts to (i) address potential issues arising from benchmark rate reform and (ii) provide authoritative guidance on hedge accounting during the 'pre-replacement' phase.

We thank you for the opportunity to provide comments on this exposure draft. Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours sincerely,

Srivatsan Lakshminarayan

Professor of Accounting and Finance,

Member, Centre for Financial Studies,

SPJIMR Business School, Mumbai, India.

srivatsan.lakshminarayan@spjimr.org

Question 1 [paragraphs 6.8.4–6.8.6 of IFRS 9 and paragraphs 102D–102F of IAS 39]

Highly probable requirement and prospective assessments

For hedges of interest rate risk that are affected by interest rate benchmark reform, the Board proposes amendments to IFRS 9 and IAS 39 as described below.

(a) For the reasons set out in paragraphs BC8–BC15, the Board proposes exceptions for determining whether a forecast transaction is highly probable or whether it is no longer expected to occur. Specifically, the Exposure Draft proposes that an entity would apply those requirements assuming that the interest rate benchmark on which the hedged cash flows are based is not altered as a result of interest rate benchmark reform.

(b) For the reasons set out in paragraphs BC16–BC23, the Board proposes exceptions to the hedge accounting requirements in IFRS 9 and IAS 39 so that an entity would assume that the interest rate benchmark on which the hedged cash flows are based, and/or the interest rate benchmark on which the cash flows of the hedging instrument are based, are not altered as a result of interest rate benchmark reform when the entity determines whether:

(i) there is an economic relationship between the hedged item and the hedging instrument applying IFRS 9; or

(ii) the hedge is expected to be highly effective in achieving offsetting applying IAS 39.

Do you agree with these proposals? Why or why not? If you agree with only parts of the proposals, please specify what you agree and disagree with. If you disagree with the proposals, please explain what you propose instead and why.

Comments

1. It is noted that the present Exposure Draft (ED) is an attempt by the Board to provide a timely response through amendments to IFRS 9 and IAS 39, during the pre-replacement phase of major inter-bank benchmark rate (IBOR) reform being undertaken under the aegis of the Financial Stability Board. By implication, the focus of this ED suggests an emphasis on reform related to LIBOR, EURIBOR and TIBOR. It is submitted that the final document issued by the Board must be unambiguously worded to include within its scope, similar reform currently being undertaken under other jurisdictions, particularly since preparers in these jurisdictions also report under IFRS.
2. BC8 as currently worded, suggests correspondence (or natural consequence) between amendment of underlying contracts to reflect alternative interest rates (arising out of IBOR reform), and failure of forecast (pre-reform) IBOR-based cash flows under such contracts to meet the 'highly probable' requirement with respect to hedged items under cash flow hedges (para 6.3.3 of IFRS 9/para 78, 80 of IAS 39). While the intent of the ED is to prevent discontinuance of hedge accounting for interest rate risk due to uncertainties arising from IBOR reform, it is suggested that in practice, assumptions regarding such discontinuity may not be warranted given consultative and risk-mitigating approaches

to such reform in many jurisdictions. Further, benchmark rates (both pre and post-reform) are often not only used as reference rates, but are also often directly identified/identifiable within contracts as a basis for pricing. Consequently, the Board may wish to suitably re-word so as to highlight the applicability of the ED to *exceptional* situations of uncertainty caused by discontinuities/delays arising during IBOR reform.

3. Barring occasional references (BC17, BC19 and BC43), the ED is largely silent on its applicability to fair value hedging relationships. It is submitted that the ED be suitably worded to explicitly clarify its applicability to fair value hedges.
4. With respect to prospective assessments, to the extent that estimates of hedging effectiveness are adversely impacted by IBOR reform arising from market conditions such as reduced liquidity of contracts referencing existing benchmark rates, the ED (see BC22) suggests that exceptions under paragraphs 6.8.6 (IFRS 9) and 102F (IAS 39) would not be available in such cases, thereby implying discontinuation of current hedge accounting for contracts referencing such rates. The guiding principles for when the exceptions articulated under Question 1 (ii) above would not apply owing to conditions specified under BC22 need to be spelt out. The effect of BC22 is to introduce exceptions to the exception under paragraphs 6.86 and 102F. In practice, it may not be possible to clearly identify or attribute uncertainties arising from IBOR reform so clearly, as to invoke BC22.
5. It is submitted that the ED must be clearly worded to ensure that the scope of amendments is not interpreted as being restricted only to hedging relationships that seek (wholly or in part) to hedge interest rate risk. The drafting of paragraphs 6.8.1 (IFRS 9) and 102A may particularly be revisited to incorporate the impact of benchmark rate reform on hedging relationships that include other types of risks in combination with interest rate risk, for e.g. cross-currency interest rate swaps.
6. As a general observation, the ED contemplates benchmark rate reform through complete replacement of the current applicable benchmark rate with an alternative rate. Reform may not necessarily take this form. Instead, benchmark rate reform may be achieved through reformulation and/or cessation of specific tenors combined with retention of other liquid tenors using a revised methodology (e.g. transactions based) for such tenors. This appears to be the case with the approach to EURIBOR reform. It is submitted that the ED must be suitably drafted to clarify its applicability to such scenarios.

Question 2 [paragraph 6.8.7 of IFRS 9 and paragraph 102G of IAS 39]

Designating a component of an item as the hedged item

For the reasons set out in paragraphs BC24–BC27, the Board proposes amendments to the hedge accounting requirements in IFRS 9 and IAS 39 for hedges of the benchmark component of interest rate risk that is not contractually specified and that is affected by interest rate benchmark reform. Specifically, for such hedges, the Exposure Draft proposes that an entity applies the requirement—that the designated risk component or designated portion is separately identifiable—only at the inception of the hedging relationship.

Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you propose instead and why.

Comments

Agree.

Question 3 [paragraphs 6.8.8–6.8.10 of IFRS 9 and paragraphs 102H–102J of IAS 39]

Mandatory application and end of application

(a) For the reasons set out in paragraphs BC28–BC31, the Board proposes that the exceptions are mandatory. As a result, entities would be required to apply the proposed exceptions to all hedging relationships that are affected by interest rate benchmark reform.

(b) For the reasons set out in paragraphs BC32–BC42, the Board proposes that the exceptions would apply for a limited period. Specifically, an entity would prospectively cease applying the proposed amendments at the earlier of:

(i) when the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and the amount of the interest rate benchmark-based cash flows; and

(ii) when the hedging relationship is discontinued, or if paragraph 6.8.9 of IFRS 9 or paragraph 102I of IAS 39 applies, when the entire amount accumulated in the cash flow hedge reserve with respect to that hedging relationship is reclassified to profit or loss.

(c) For the reasons set out in paragraph BC43, the Board is not proposing an end of application in relation to the separate identification requirement.

Do you agree with these proposals? Why or why not? If you agree with only parts of the proposals, please specify what you agree and disagree with. If you disagree with the proposals, please explain what you propose instead and why.

Comments

Agree with respect to (a) above.

Part (b) can be simplified to restrict the end of application to situations when the reporting entity judges that it is able to estimate the impact of IBOR reform with sufficient certainty with respect to timing and amount of cash flows. Judgement regarding such certainty must incorporate transitional aspects that counterparties are/will be reasonably expected to address while contractually incorporating the alternate benchmark rate in lieu of the old benchmark rate.

Question 4 [paragraph 6.8.11 of IFRS 9 and paragraph 102K of IAS 39]

Disclosures

For the reasons set out in paragraph BC44, the Board proposes that entities provide specific disclosures about the extent to which their hedging relationships are affected by the proposed amendments.

Do you agree with these proposed disclosures? Why or why not? If not, what disclosures would you propose instead and why?

Comments

Agree. It is submitted that illustrative guidance should be incorporated.

Question 5 [paragraphs 7.1.9 and 7.2.26(d) of IFRS 9 and paragraph 108G of IAS 39]

Effective date and transition

For the reasons set out in paragraphs BC45–BC47, the Board proposes that the amendments would have an effective date of annual periods beginning on or after 1 January 2020. Earlier application would be permitted. The Board proposes that the amendments would be applied retrospectively. No specific transition provisions are proposed.

Do you agree with these proposals? Why or why not? If you disagree with the proposals, please explain what you propose instead and why.

Comments

Agree.

Additional Comment:

It is submitted that the Board must develop a plan to address potential issues likely to arise from transition to alternative/modified benchmark rates (replacement phase). The current ED, Board deliberations and feedback received suggest that the need for adding replacement phase issues to the agenda is imminent.